

FILED

JOSEPH F. SPANOL, JR.  
CLERK

**Supreme Court of the United States**  
**Scholar Term, 1985**

**ETS CORPORATION,**

*Appellant,*

**DYNAMICS CORPORATION OF AMERICA,**

*Appellee.*

**STATE OF INDIANA,**

*Intervenor Appellant,*

**DYNAMICS CORPORATION OF AMERICA,**

*Appellee.*

**On Appeal From The United States Court Of Appeals  
For The Seventh Circuit**

**BRIEF FOR APPELLEE DYNAMICS  
CORPORATION OF AMERICA**

**LOWELL E. SACHNOFF**

*Counsel of Record for Appellee*

**WILLIAM N. WEAVER, JR.**

**DEAN A. DEKIE**

**SARAH R. WOLFF**

**MICHAEL J. KAUFMAN**

**THOMAS J. BAMONTE**

**OF SACHNOFF WEAVER & RUBENSTEIN, LTD.**

**80 S. Wacker Drive**

**Suite 2900**

**Chicago, Illinois 60606**

**(312) 207-1000**

**BEST AVAILABLE COPY**

## QUESTION PRESENTED

Whether the Control Share Chapter of the Indiana Business Corporation Law (the "Chapter") is unconstitutional where:

1. The Chapter (a) has a protectionist purpose, (b) directly regulates interstate commerce between nonresident parties, (c) has discriminatory effects on interstate commerce and (d) burdens interstate commerce in a manner that far outweighs any local benefits; and

2. The Chapter conflicts with (a) the Williams Act's market method of investor protection by subjecting a shareholder's decision to sell its shares to the prior approval of management and at least two shareholder groups and (b) the policy of neutrality between management and tender offerors upon which the investor protections of the Williams Act rest.

## PARTIES TO PROCEEDINGS BELOW

Seventh Circuit No. 86-1601 involved the constitutional questions presented by this appeal. The parties were: Dynamics Corporation of America ("DCA"), as plaintiff-appellee; CTS Corporation ("CTS"), Robert D. Hostetler, Gary B. Erekson, and Joseph DiGirolamo (officers and/or directors of CTS), as defendants-appellants; and the State of Indiana ("Indiana"), as intervenor-appellant.

Seventh Circuit No. 86-1608 involved the same action in the District Court, was consolidated with No. 86-1601, but did not involve the constitutional questions presented by the present appeal. The parties were: DCA, Andrew Lozyniak, Edward J. Mooney, Henry V. Kensing, Patrick J. Dorme, Frank A. Gunter, Curtis T. Roff, Saul Sperber, Joseph P. Walker and Harold Cohan (officers and/or directors of DCA) as plaintiffs-appellees; and CTS, Robert D. Hostetler, Gary B. Erekson, Joseph DiGirolamo, George F. Sommer, Gerald H. Frieling, Jr., Don J. Kacek, Ted Ross and Richard M. Ringoen (officers and/or directors of CTS) as defendants-appellants.

*Rule 28.1 Listing.* Appellee DCA has no parent corporation, non-wholly owned subsidiaries, or affiliates.

## TABLE OF CONTENTS

	<i>Page</i>
QUESTION PRESENTED .....	i
PARTIES TO PROCEEDINGS BELOW .....	ii
TABLE OF CONTENTS .....	iii
TABLE OF AUTHORITIES .....	vi
CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED .....	xv
COUNTER-STATEMENT OF THE CASE .....	1
A. The Chapter Regulates Interstate Tender Offers And Securities Transactions ...	1
B. This Case Illustrates The Chapter's Regulatory Impact On Interstate Tender Offers .....	5
SUMMARY OF ARGUMENT .....	7
ARGUMENT .....	9
I. THE CHAPTER VIOLATES THE COMMERCE CLAUSE .....	9
A. The Chapter Has An Unlawful Protectionist Purpose .....	10
B. The Chapter Directly Regulates Interstate Commerce .....	11
C. The Chapter's Effects On Interstate Commerce Are <i>Per Se</i> Unconstitutional .....	13
1. The Chapter Has A Discriminatory Effect On Nonresident Tender Offerors In The Interstate Market For Corporate Control .....	13

	<i>Page</i>
2. The Chapter Impedes The Interstate Transfer Of Corporate Assets .....	15
3. The Chapter Requires Economic Operations To Be Performed In Indiana Which Could More Efficiently Be Performed Elsewhere .....	16
4. The Chapter Benefits The Management Of Indiana Corporations At The Expense Of Unrepresented Nonresident Parties .....	17
D. The Chapter's Unnecessary Burdens On Interstate Commerce Far Outweigh Any Local Benefits .....	20
1. The Burdens On Interstate Commerce Are Great .....	20
2. The Chapter's Benefits Are Negligible .....	21
a. The Rationale Of Protecting Nondominant Shareholders Is A Pretext .....	21
i. Management's Exemption Power Is Inconsistent With Shareholder Protection .....	21
ii. The Chapter Is Not Rationally Related To Its Purported Purpose .....	22
iii. The Chapter Is Based Upon Irrational Premises .....	24
b. The Chapter Provides No Legitimate Benefit To Other Local Interests ..	26
3. Appellants' "Internal Corporate Affairs" Argument Is Without Merit .....	26
4. Congress Has Not Delegated This Regulatory Authority To The States .....	29

	<i>Page</i>
II. THE CHAPTER IS PREEMPTED BY THE WILLIAMS ACT .....	29
A. The Chapter Conflicts With The Williams Act's Market Method Of Investor Protection .....	30
B. The Chapter Frustrates The Williams Act's Investor Protection Purpose By Conflicting With Its Policy Of Neutrality ..	34
CONCLUSION .....	39



## TABLE OF AUTHORITIES

Cases	Page
<i>APL Ltd. Partnership v. Van Dusen Air, Inc.</i> , 622 F. Supp. 1216 (D. Minn.), vacated on other grounds, and appeal dismissed, Nos. 85- 5285/5286-MN (8th Cir. Nov. 26, 1985) . . . . .	12
<i>Baldwin v. G.A.F. Seelig, Inc.</i> , 294 U.S. 511 (1935) . . . . .	10
<i>Brown-Forman Distillers Corp. v. New York State Liquor Auth.</i> , 476 U.S. ___, 106 S. Ct. 2080 (1986) . . . . .	12, 18
<i>Dean Milk Co. v. Madison</i> , 340 U.S. 349 (1951) . . . . .	20
<i>Dynamics Corp. of America v. CTS Corp.</i> , 805 F.2d 705 (7th Cir. 1986) . . . . .	7, 23
<i>Dynamics Corp. of America v. CTS Corp.</i> , 794 F.2d 250 (7th Cir.), appeal docketed, Nos. 86- 71/86-97 (U.S. July 22, 1986) . . . . .	7, 29
<i>Dynamics Corp. of America v. CTS Corp.</i> , 1986-1 Trade Cas. (CCH) ¶ 67,134 (7th Cir. Apr. 23, 1986) . . . . .	7
<i>Dynamics Corp. of America v. CTS Corp.</i> , [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,765 (N.D. Ill. May 3, 1986) . . . . .	7
<i>Dynamics Corp. of America v. CTS Corp.</i> , 643 F. Supp. 215 (N.D. Ill. 1986) . . . . .	4, 7
<i>Dynamics Corp. of America v. CTS Corp.</i> , 638 F. Supp. 802 (N.D. Ill.), aff'd in part and va- cated and remanded in part, 805 F.2d 705 (7th Cir. 1986) . . . . .	7
<i>Dynamics Corp. of America v. CTS Corp.</i> , 637 F. Supp. 389 (N.D. Ill.), aff'd, 794 F.2d 250 (7th Cir. 1986) . . . . .	7

	Page
<i>Dynamics Corp. of America v. CTS Corp.</i> , 637 F. Supp. 406 (N.D. Ill. 1986) . . . . .	7
<i>Dynamics Corp. of America v. CTS Corp.</i> , 635 F. Supp. 1174 (N.D. Ill.), aff'd in part, vacated and remanded in part, 805 F.2d 705 (7th Cir. 1986) . . . . .	7
<i>Edgar v. MITE Corp.</i> , 457 U.S. 624 (1982) . . . . .	12, passim
<i>Exxon Corp. v. Governor of Maryland</i> , 437 U.S. 117 (1978) . . . . .	26, 27
<i>Fleet Aerospace Corp. v. Holderman</i> , 637 F. Supp. 742 (S.D. Ohio), aff'd, 796 F.2d 135 (6th Cir.), appeal docketed, No. 86-344 (U.S. Sept. 2, 1986) . . . . .	3, 12
<i>Gelco Corp. v. Coniston Partners</i> , Civ. No. 3-86- 847 (D. Minn. Nov. 10, 1986) . . . . .	12
<i>Great W. United Corp. v. Kidwell</i> , 577 F.2d 1256 (5th Cir. 1978), rev. on venue grounds sub nom., <i>Leroy v. Great W. United Corp.</i> , 443 U.S. 173 (1979) . . . . .	30
<i>Hood &amp; Sons, Inc. v. DuMond</i> , 336 U.S. 525 (1949) . . . . .	10, 19
<i>Hines v. Davidowitz</i> , 312 U.S. 52 (1941) . . . . .	30
<i>Hughes v. Oklahoma</i> , 441 U.S. 322 (1979) . . . . .	15
<i>Hunt v. Washington Apple Advertising Comm'n</i> , 432 U.S. 333 (1977) . . . . .	18
<i>Icahn v. Blunt</i> , 612 F. Supp. 1400 (W.D. Mo. 1985) . . . . .	3, 12
<i>Lewis v. BT Inv. Managers Inc.</i> , 447 U.S. 27 (1980) . . . . .	13, 26, 27

	<i>Page</i>
<i>Maine v. Taylor</i> , 477 U.S.____, 106 S. Ct. 2440 (1986).....	11, 16, 29
<i>Philadelphia v. New Jersey</i> , 437 U.S. 617 (1978).....	10, 15, 20
<i>Pike v. Bruce Church, Inc.</i> , 397 U.S. 137 (1970).....	17, 20
<i>Piper v. Chris-Craft Indus.</i> , 430 U.S. 1 (1977).....	34
<i>Raymond Motor Trans., Inc. v. Rice</i> , 434 U.S. 429 (1978).....	22
<i>Rondeau v. Mosinee Paper Corp.</i> , 422 U.S. 49 (1975).....	32
<i>Schreiber v. Burlington N., Inc.</i> , 472 U.S. 1 (1985).....	30, 31
<i>South-Central Timber Dev., Inc. v. Wunnicke</i> , 467 U.S. 82 (1984) .....	10, 18
<i>Southern Pac. Co. v. Arizona</i> , 325 U.S. 761 (1945).....	15
<i>Terry v. Yamashita</i> , 643 F. Supp. 161 (D. Haw. 1986).....	12
<i>Toomer v. Witsell</i> , 334 U.S. 385 (1948) .....	17
<i>Unocal Corp. v. Mesa Petroleum Co.</i> , 493 A.2d 946 (Del. 1985) .....	22

### Constitutional Provisions

	<i>Page</i>
Commerce Clause, U.S. CONST. art. I, § 8, cl. 3 .....	9, <i>passim</i>
Supremacy Clause, U.S. CONST. art. VI, cl. 2 ...	9, 38

### Statutes and Regulations

Clayton Act, Section 8, 15 U.S.C. § 19 (1982) ...	6
Securities Act of 1933, 15 U.S.C. § 77e (1964) ...	31
Securities Exchange Act of 1934, 15 U.S.C. § 78a- 78kk (1982) .....	xv
 <b>Specific Sections:</b>	
Section 14, 15 U.S.C. § 78n (1964) .....	30
Section 28(a), 15 U.S.C. § 78bb(a) (1982) ...	29
Williams Act Amendments to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78l(i), 78m(d)-(e), 78n(d)-(f) (1982 & Supp. III 1985) .	7, <i>passim</i>
 <b>Specific Sections:</b>	
15 U.S.C. § 78m(d) (1982) .....	32
15 U.S.C. § 78m(d)(1) (1982) .....	4, 32
15 U.S.C. § 78m(d)(1)(C) (1982) .....	23
15 U.S.C. § 78n(d)(5) (1982) .....	3, 32
15 U.S.C. § 78n(d)(6) (1982) .....	32
15 U.S.C. § 78n(d)(7) (1982) .....	32
17 C.F.R. § 240.14e-(1)(a) (1986) .....	3, 32
Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 1311 (1982) .....	35

	<i>Page</i>
16 C.F.R. § 803.10(b) (1986) . . . . .	36
Indiana Business Corporation Law, IND. CODE	
§§ 23-1-17-1 to 23-1-54-2 (1986) . . . . .	1
<b>Specific Sections:</b>	
IND. CODE § 23-1-17-3(b) (1986) . . . . .	2
IND. CODE § 23-1-17-3(b)(1)-(2) (1986) . . . . .	2
IND. CODE § 23-1-17-5 (1986) . . . . .	1
IND. CODE § 23-1-22-4(c)(3) (1986) . . . . .	2
IND. CODE § 23-1-29-1 <i>et seq.</i> (1986) . . . . .	5
IND. CODE § 23-1-29-3(2)(A) (1986) . . . . .	5
IND. CODE § 23-1-38-4(a) (1986) . . . . .	3
IND. CODE § 23-1-40-3 (1986) . . . . .	23
IND. CODE § 23-1-41-2 (1986) . . . . .	23
Control Share Acquisitions Chapter of the Indiana Business Corporation Law, IND. CODE §§ 23-1-42-1 to 11 (1986) . . . . .	xv

**Specific Sections:**

IND. CODE § 23-1-42-1 (1986) . . . . .	1
IND. CODE § 23-1-42-3(1) (1986) . . . . .	3
IND. CODE § 23-1-42-4 (1986) . . . . .	1
IND. CODE § 23-1-42-5 (1986) . . . . .	2
IND. CODE § 23-1-42-7(a) (1986) . . . . .	3, 4
IND. CODE § 23-1-42-7(b) (1986) . . . . .	3
IND. CODE § 23-1-42-7(c) (1986) . . . . .	5

	<i>Page</i>
IND. CODE § 23-1-42-8(b) (1986) . . . . .	4
IND. CODE § 23-1-42-9(a) (1986) . . . . .	2
IND. CODE § 23-1-42-9(b) (1986) . . . . .	3
IND. CODE § 23-1-42-9(b)(1) (1986) . . . . .	3
IND. CODE § 23-1-42-9(b)(2) (1986) . . . . .	2
IND. CODE § 23-1-42-10(a) (1986) . . . . .	4, 5
IND. CODE § 23-1-42-10(b) (1986) . . . . .	2, 4
IND. CODE § 23-1-42-11(b)-(c) (1986) . . . . .	5
IND. CODE § 23-1-43-1 <i>et seq.</i> (1986) . . . . .	23, 24
IND. CODE § 23-1-44-1 <i>et seq.</i> (1986) . . . . .	23
IND. CODE § 23-1-45-2(b)(2) (1986) . . . . .	23
Indiana Takeover Offers Act, IND. CODE § 23-2-3.1 <i>et seq.</i> (1986) . . . . .	6
Take-Over-Bid Disclosure Act, VA. CODE ANN. §§ 13.1-528 (1985 Replacement Volume)	31

**Rules**

FED. R. APP. P. 28(d) . . . . .	1
SUP. CT. R. 28.1 (1980) . . . . .	ii



## Legislative History

	Page
H.R. 10650, 94th Cong., 1st Sess., 121 CONG. REC. 35640 (1975) . . . . .	36
S. 2522, 94th Cong., 1st Sess., 121 CONG. REC. 32839 (1975) . . . . .	36
S. 2731, 89th Cong., 1st Sess., 111 CONG. REC. 28257 (1965) . . . . .	36
<i>Investor Protections in Corporate Takeovers:</i> <i>Hearings on H.R. 4285, S. 3431 and S. 336</i> <i>Before the Subcomm. on Commerce and Finance</i> <i>of the House Comm. on Interstate and Foreign</i> <i>Commerce, 91st Cong., 2d Sess. (1970) . . . . .</i>	36
<i>Takeover Bids: Hearing on H.R. 14475 Before</i> <i>the Subcomm. on Commerce and Finance of</i> <i>the House Comm. on Interstate and Foreign</i> <i>Commerce, 90th Cong., 2d Sess. (1968) . . . . .</i>	36
<i>Full Disclosure of Corporate Equity Ownership and</i> <i>in Corporate Takeover Bids: Hearings on S. 510</i> <i>Before the Subcomm. on Securities of the Senate</i> <i>Comm. on Banking and Currency, 90th Cong.,</i> <i>1st Sess. (1967) . . . . .</i>	31, 34, 36
H.R. Rep. No. 1711, 90th Cong., 2d Sess., reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811 . . . . .	31, 32, 34
H.R. Rep. No. 1373, 94th Cong., 2d Sess., reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 2572	36
S. Rep. No. 550, 90th Cong., 1st Sess. (1967) . . .	32, 34, 36
122 CONG. REC. 30877 (1976) . . . . .	36
113 CONG. REC. 854 (1967) . . . . .	35

## Other Authorities

	Page
Block, Barton and Roth, <i>State Takeover Statutes:</i> <i>The Second Generation</i> , 13 SEC. REG. L. J. 332 (1986) . . . . .	12
Bradley, Desai and Kim, <i>The Rationale Behind</i> <i>Interfirm Tender Offers</i> , 11 J. FIN. ECON. 183 (1983) . . . . .	20
<i>CTS Reports on Tender</i> (NEXIS, PR Newswire, Feb. 26, 1982) . . . . .	18
<i>CTS Corp. Acquisition</i> (NEXIS, PR Newswire, Jan. 11, 1982) . . . . .	18
3 <i>Corporate Control Alert</i> 1 (April 1986) . . . . .	16
3 <i>Corporate Control Alert</i> 1 (March 1986) . . . . .	11, 20
Easterbrook and Fischel, <i>The Proper Role of a</i> <i>Target's Management in Responding to a Tender</i> <i>Offer</i> , 94 HARV. L. REV. 1161 (1981) . . . . .	16
Fischel, <i>Efficient Capital Market Theory, the Market</i> <i>for Corporate Control, and the Regulation of</i> <i>Cash Tender Offers</i> , 57 TEX. L. REV. 1 (1978) . . . . .	16
Gilson, <i>A Structural Approach to Corporations: The</i> <i>Case Against Defensive Tactics in Tender Offers</i> , 33 STAN. L. REV. 819 (1981) . . . . .	17
Ginsburg and Robinson, <i>The Case Against Federal</i> <i>Intervention in the Market for Corporate Control</i> , 1986 Winter/Spring BROOKINGS REV. 9 . . . . .	15
Holderness and Sheehan, <i>Raiders or Saviors? The</i> <i>Evidence on Six Controversial Investors</i> , 14 J. FIN. ECON. 555 (1985) . . . . .	25
Jensen and Ruback, <i>The Market for Corporate</i> <i>Control: The Scientific Evidence</i> , 11 J. FIN. ECON. 5 (1983) . . . . .	14, 16



	<i>Page</i>
1 L. Loss, <i>Securities Regulation</i> (2d ed. 1961) . . .	29
Manne, <i>Mergers and the Market for Corporate Control</i> , 73 J. POL. ECON. 110 (1965) . . . . .	16
Mikkelsen and Ruback, <i>An Empirical Analysis of the Interfirm Equity Investment Process</i> , 14 J. FIN. ECON. 523 (1985) . . . . .	25, 28
Romano, <i>The Political Economy of Takeover Statutes</i> , 41 VA. L. REV. ____ (1987) (forthcoming in February, 1987) . . . . .	18, 20
Schleifer and Vishny, <i>Large Shareholders and Corporate Control</i> , 94 J. POL. ECON. 461 (1986) . . . . .	25
Securities and Exchange Commission's Advisory Committee on Tender Offers, <i>The Economics of Partial and Two-Tier Tender Offers</i> , 49 FED. REG. 26755 (1984) . . . . .	24

## CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

This case involves the following constitutional provisions and statutes:

1. Supremacy Clause, U.S. CONST. art. VI, cl. 2.
2. Commerce Clause, U.S. CONST. art. I, § 8, cl. 3.
3. Williams Act Amendments to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78l(i) 78m(d)-(e) 78n(d)-(f) (1982 & Supp. III 1985).
4. Control Share Acquisitions Chapter of the Indiana Business Corporation Law, IND. CODE §§ 23-1-42-1 to 11 (1986).

## COUNTER-STATEMENT OF THE CASE

In their statements of the case, appellants<sup>1</sup> argue that the Chapter is merely a voting provision which does not "restrict," "govern" or "regulate" interstate tender offers or the interstate purchase and sale of securities. (CTS Br. at 3-4, Ind. Br. at 10-11.) Such assertions, however, ignore the Chapter's provisions and the facts of this case.

### A. The Chapter Regulates Interstate Tender Offers And Securities Transactions

The Chapter is part of the revised Indiana Business Corporation Law ("Business Corporation Law"), IND. CODE §§ 23-1-17-1 to 23-1-54-2 (1986).<sup>2</sup> It removes existing shareholder voting rights from so-called "control shares." IND. CODE § 23-1-42-1. The Chapter defines "control shares" as the block of shares of an Indiana corporation that when purchased will put an "acquiring person" over certain share ownership thresholds: 20%, 33.3% and 51%. IND. CODE § 23-1-42-1. It applies to a variety of "control share acquisitions," including interstate tender offers which cross any of the ownership thresholds. IND. CODE § 23-1-42-1. The Chapter governs tender offers even if 90% of the corporation's shareholders, its principal place of business, its principal office and the tender offeror are located outside Indiana. IND. CODE § 23-1-42-4.

---

<sup>1</sup>DCA respectfully requests the Court's indulgence when it refers to "appellants" rather than the more unwieldy formulation "CTS and Indiana." See Fed. R. App. P. 28(d). Their arguments are substantially the same.

<sup>2</sup>The Chapter does not contain a statement of purpose and no official legislative history of the Business Corporation Law has been published. Section 23-1-17-5 of the Business Corporation Law permits a General Corporation Law Study Commission to publish official comments on the Chapter. No such comments have been published as of January, 1987. If later published, such comments should be given little weight by this Court because they will have been drafted after DCA challenged the Chapter.

The Chapter applies to all Indiana corporations that are "issuing public corporations."<sup>3</sup> IND. CODE § 23-1-42-5. At the same time it establishes procedures by which incumbent management may decide whether and when to invoke its provisions. The Chapter empowers incumbent management to opt out of (or back into) the Chapter without shareholder approval. IND. CODE § 23-1-42-5. See also IND. CODE § 23-1-22-4(c)(3) (permitting Indiana corporations to adopt defensive measures against changes in corporate control without shareholder approval). It imposes no limits on managerial discretion.

Once it is triggered, the Chapter removes the voting rights from all shares tendered. The statute applies regardless of the nature of the tender offer or the intentions of the tender offeror. It applies regardless of the performance of incumbent management or the potential benefits of the acquisition to shareholders, the corporation or Indiana citizens. The tender offeror can only recover its voting rights pursuant to a statutory procedure administered by management and "only to the extent granted by resolution approved by the shareholders . . ." IND. CODE § 23-1-42-9(a).<sup>4</sup> At a minimum, a majority of (1) all shareholders and (2) all shareholders "excluding all interested shares" must

<sup>3</sup>The Chapter as part of the Business Corporation Law becomes generally applicable on August 1, 1987. IND. CODE § 23-1-17-3(b). Indiana corporations were permitted to opt into the Business Corporation Law after April 1, 1986. IND. CODE § 23-1-17-3(b)(1)-(2). CTS was the first Indiana corporation to adopt the Business Corporation Law. (R. 55, Exh. A.)

<sup>4</sup>Thus, the Chapter allows management to propose that the acquiring person be granted restricted voting rights. Such restricted voting rights might, for example, prohibit the acquiring person from participating in the selection of the company's board of directors. See IND. CODE § 23-1-42-9(b)(2). Gaining limited voting rights would be a Pyrrhic victory for the acquiring person because the Chapter permits management to redeem shares not given full voting rights. IND. CODE § 23-1-42-10(b).

approve a resolution reenfranchising the "control shares" with some or all of the voting rights. IND. CODE § 23-1-42-9(b).<sup>5</sup> Shareholders are disqualified from voting on the voting rights resolution as "disinterested" persons if the tender offeror votes their proxies. IND. CODE § 23-1-42-3(1).

The tender offeror can request a special shareholders meeting on the voting rights issue. IND. CODE § 23-1-42-7(a). The request is not a vehicle for "prompt" shareholder resolution of that issue. (CTS Br. at 4.) Although federal law permits tender offerors to purchase tendered shares 20 business days (*circa* 28 calendar days) after making a tender offer, 17 C.F.R. § 240.14e-1a (1986), the Chapter allows management to delay the meeting for 50 days, IND. CODE § 23-1-42-7(b). In practice, resolution of the voting rights issue will take longer than 50 days, considering the time it will take to count the shareholder ballots and to conclude any litigation arising out of the special shareholders meeting, proxy solicitations and ballot counting process.<sup>6</sup> If this delay is only 10 days beyond the 50 day period, the tendering shareholders will regain their withdrawal rights under the Williams Act,

<sup>5</sup>In control share transactions that implicate § 23-1-38-4(a) of the Indiana Business Corporation Law by, for example, causing the issuance of a new class of stock, more than two voting groups must approve the voting rights resolution. See IND. CODE § 23-1-42-9(b)(1). Appellants' self-serving interpretation of § 23-1-42-9(b) is contrary to its plain language and the interpretations of the District Court, CTS App. 38-39, the Seventh Circuit, CTS App. at 20, and other courts that have considered similar voting requirements. See, e.g., *Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. 742, 750-53 (S. D. Ohio), *aff'd*, 796 F.2d 135 (6th Cir.) *appeal docketed*, No. 86-344 (U.S. Sept. 2, 1986); *Icahn v. Blunt*, 612 F. Supp. 1400, 1406-1407 (W.D. Mo. 1985).

<sup>6</sup>There is an inevitable delay in counting the votes after a shareholders meeting. For example, in this case it took 14 days

(Footnote continued on the following page)



15 U.S.C. § 78n(d)(5). The exercise of these withdrawal rights will terminate a tender offer.<sup>7</sup>

To obtain a special shareholders meeting, the tender offeror must file an "acquiring person statement" and give an undertaking to pay the corporation's expenses of holding a special shareholders meeting. IND. CODE § 23-1-42-7(a).<sup>8</sup> The information to be supplied in the acquiring person statement is duplicative of that which tender offerors must supply to the corporation and its shareholders under the Williams Act, 15 U.S.C. § 78m(d)(1). The Chapter does not require the tender offeror to disclose any additional information which may help shareholders resolve the voting rights issue. IND. CODE § 23-1-42-8(b).

The Chapter allows management to redeem any purchased shares not accorded full voting rights "at the fair value thereof pursuant to the procedures adopted by the corporation." IND. CODE § 23-1-42-10(a)-(b). The Chapter does not define "fair value" for purposes of the corporation's redemption of the tender offeror's shares. It may, however, require tender offerors to pay dissenting shareholders for their shares at a "fair value" above market price.

<sup>6</sup> (Continued)

to tally the votes cast at the 1986 CTS Annual Meeting. See *Dynamics Corp. of America v. CTS Corp.*, 643 F. Supp. 215, 216-217 (N.D. Ill. 1986). DCA challenged the election results. It took the District Court approximately three weeks to rule on DCA's request for a preliminary injunction in connection with its challenge.

<sup>7</sup> If, upon the expiration of the 60 day period, the tender offeror makes a revised offer, then management could require the tender offeror to file a revised acquiring person statement, and the 50 day period for a shareholder vote would begin running anew.

<sup>8</sup> It is unclear under the Chapter whether the acquiring person is responsible for the corporation's litigation expenses arising out of the special shareholders meeting, which expenses could be substantial.

IND. CODE § 23-1-42-11(b)-(c). The Chapter also regulates those tender offerors who do not file an acquiring person statement. It permits management to delay a vote on a voting rights resolution until the next annual meeting. IND. CODE § 23-1-42-7(c).<sup>9</sup> The Chapter also empowers management to redeem the shares tendered to the non-filing tender offeror 60 days after announcing the tender offer. IND. CODE § 23-1-42-10(a).

### B. This Case Illustrates The Chapter's Regulatory Impact On Interstate Tender Offers

CTS is an Indiana corporation and DCA is a New York corporation headquartered in Connecticut. (CTS App. at 5.) Both companies are publicly owned and their stock is traded on the New York Stock Exchange. (Id.) Approximately two-thirds of CTS shareholders reside outside of Indiana. (DCA App. at 59.) On March 10, 1986, DCA, then CTS' largest shareholder, commenced a tender offer for 1,000,000 additional shares of CTS stock at \$43 per share (CTS App. at 1, 5), a premium of more than 20% above market price. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 253 (7th Cir.), appeal docketed Nos. 86-71/86-97 (U.S. July 22, 1986). The

<sup>9</sup> Acquiring persons cannot compel prompt consideration of the voting rights issue by calling a special shareholders meeting under § 23-1-29-1 *et seq.* of the Business Corporation Law. First, Indiana law requires the holders of 25% of the shares to request a special shareholders meeting before it must be called by the corporation. IND. CODE § 23-1-29-2(a)(2). Many acquiring persons and most tender offerors will not have that level of share ownership. Second, Indiana law allows Indiana corporations to delay the notice of a special shareholders meeting for 60 days and forces the shareholders who called for a special meeting to then go to an Indiana court for an order compelling the corporate directors to hold a special meeting. IND. CODE § 23-1-29-3(2)(A). A mere 60 day delay subjects the "control shares" to redemption. IND. CODE § 23-1-42-10(a).



offer complied with the Williams Act and was designed to expire on April 10, 1986, 20 business days later. (DCA App. at 84.) DCA also announced a proxy campaign to elect its slate of nominees to the CTS Board of Directors at the April 24, 1986 Annual Meeting ("Annual Meeting"). (Id. at 12.)

As part of its effort to block DCA's tender offer and proxy solicitation,<sup>10</sup> CTS adopted the Chapter. (DCA App. at 52-57.) CTS said it would use the Chapter to remove the voting rights from the shares tendered to DCA by other shareholders. (Id. at 51; CTS App. at 34-35.) CTS also stated in filings with the District Court that it would not hold a special shareholders meeting on the voting rights issue before the Annual Meeting. (DCA App. at 50.)

Had CTS been able to enforce the Chapter, DCA could not have voted the tendered shares at the Annual Meeting. DCA therefore extended its tender offer and sought a declaratory judgment that the Chapter is unconstitutional. The District Court issued the declaratory judgment. The Seventh Circuit affirmed the District Court's decision on April 23, 1986, and DCA promptly purchased 1,000,000 of the tendered shares.

<sup>10</sup> Among other things, CTS (1) invoked the Indiana Takeover Offers Act, IND. CODE § 23-2-3.1 *et seq.* (1986), by requesting a hearing before the Indiana Securities Commissioner on the adequacy of DCA's disclosures and filing an action in Indiana state court seeking to halt DCA's tender offer; (2) filed numerous counterclaims in the District Court seeking to enjoin DCA's tender offer and proxy solicitation on the grounds that, *inter alia*, DCA's disclosures were misleading and seating DCA's nominees on the CTS Board would violate Section 8 of the Clayton Act, 15 U.S.C. § 19 (1982); (3) adopted in succession three "poison pill" shareholder rights plans designed to thwart DCA's tender offer and proxy solicitation; and (4) issued false and misleading communications in connection with its adoption

## SUMMARY OF ARGUMENT

This appeal arises from the actions of current management and directors (collectively "management") of appellant CTS, who, in an all-out effort to defeat a tender offer from an out-of-state bidder which complied with all federal requirements, rushed to opt into the Chapter 16 months before it became generally applicable to all Indiana corporations. At issue is whether Indiana can insulate its resident corporations from the interstate markets for corporate control, assets and securities through legislation that conflicts directly with the investor protection goals and mechanisms established by Congress in the Williams Act, 15 U.S.C. §§ 781(i), 78m(d)-(e), 78n(d)-(f) (1982 & Supp. III 1985).

The Chapter, which can be invoked by management at will, strips voting rights from the securities that put a tender offeror over certain ownership thresholds. The tender offeror can only regain these voting rights by running a statutory gauntlet of pro-management provisions.

### <sup>10</sup> (Continued)

of the second poison pill. Except with respect to the second poison pill, which CTS redeemed after an unfavorable Seventh Circuit decision, *see Dynamics Corp. of America v. CTS Corp.*, 805 F.2d 705 (7th Cir. 1986), and the third poison pill, the legality of which is before the District Court, the District Court, Seventh Circuit and Indiana Securities Commissioner have rejected all of CTS' defensive measures. The following is a list of the published opinions rendered in this case by the lower courts: 805 F.2d 705 (7th Cir. 1986); 794 F.2d 250 (7th Cir. 1986), *appeal docketed* Nos. 86-71/86-97 (U.S. July 22, 1986); 1986-1 Trade Cas. (CCH) ¶ 67,134 (7th Cir. April 23, 1986); 643 F. Supp. 215 (N.D. Ill. 1986); 638 F. Supp. 802 (N.D. Ill.), *aff'd in part and vacated and remanded in part*, 805 F.2d 705 (7th Cir. 1986); 637 F. Supp. 406 (N.D. Ill. 1986); 637 F. Supp. 389 (N.D. Ill.), *aff'd* 794 F.2d 250 (1986); 635 F. Supp. 1174 (N.D. Ill.), *aff'd in part, vacated in part and remanded in part*, 805 F.2d 705 (7th Cir. 1986); [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 92, 765 (N.D. Ill. 1986).

The Chapter empowers management to delay shareholder consideration of a resolution on the voting rights issue for up to 50 days. No rational tender offeror will purchase tendered shares until the voting rights issue is resolved because of the high risk of being left without voting rights to protect its investment.

Under the Chapter's regulatory scheme, shareholders are deprived of their ability freely to tender and sell their shares to the tender offeror. In effect the Chapter subjects the individual shareholder's investment decision to the approval of three groups: management, all shareholders and all "disinterested" shareholders.

The Chapter is *per se* violative of the Commerce Clause. As admitted by Indiana and counsel for CTS, the Chapter has a protectionist purpose. The Chapter directly regulates interstate securities transactions between non-resident shareholders and tender offerors. The Chapter has substantial discriminatory effects on interstate commerce. It discriminates against nonresident tender offerors in the interstate market for corporate control, impedes the interstate flow of corporate assets, forces economic operations that might be performed more efficiently elsewhere to be performed in Indiana, and unduly shifts its burdens to unrepresented out-of-state parties.

The Chapter heavily burdens the interstate markets for corporate control, corporate assets and securities. Indiana has little to counterbalance these burdens. It has no interest in protecting out-of-state shareholders. The *post hoc* rationalizations it offers for the Chapter are flimsy at best. The extreme pro-management bias of the Chapter is inconsistent with shareholder protection and the "threats" to which the Chapter purportedly responds are illusory. Appellants draw a false analogy between tender offers and fundamental corporate changes. Indiana law already regulates the way in which the tender offeror may use its shares if it wishes to make a fundamental

change in the corporate structure.

Congress has not delegated to the states the power to interfere with interstate tender offers. To the contrary, the Chapter is preempted by the Williams Act. Congress adopted a market method of tender offer regulation that is designed to provide information to shareholders, who then are free to choose to tender and sell their shares to the tender offeror. In direct contrast, the Chapter establishes a regulatory scheme that subjects investor free choice to the "tender mercies" of management and at least two groups of shareholders.

The Chapter also conflicts with the policy of neutrality that underlies the investor protections of the Williams Act. As Congress recognized, without this policy, management will be able to subvert shareholder free choice by thwarting value-maximizing tender offers. With its pro-management weapons, the Chapter threatens the very scheme of investor protections established by Congress.

Both the District Court and the Seventh Circuit saw through appellants' characterization of the Chapter as an innocuous and isolated piece of shareholder voting legislation. They properly gauged the severe practical impact of the Chapter and concluded that it regulates tender offers in a manner that violates both the Commerce and Supremacy Clauses.

## ARGUMENT

### I. THE CHAPTER VIOLATES THE COMMERCE CLAUSE

The Chapter is *per se* violative of the Commerce Clause, U.S. CONST. art. I, § 8, cl. 3, because (1) its acknowledged purpose is to protect Indiana companies from the interstate market for corporate control, (2) its method of achieving that purpose is the direct regulation of securities transactions between out-of-state shareholders and tender offerors, and (3) its provisions have discriminatory effects on interstate commerce. Furthermore,



the Chapter violates the Commerce Clause because its multiple burdens on interstate commerce greatly outweigh any local benefits.

Appellants' argument is driven by the assumption that if they characterize the Chapter *ipse dixit* as a harmless regulation of voting rights, it will withstand Commerce Clause scrutiny. Voting rights, however, do not exist in a vacuum. They are attached to securities that are traded in national – indeed international – markets.<sup>11</sup> No rational tender offeror will purchase shares without knowing whether they will include voting rights. To do so would be like buying a car before knowing whether it had an engine. Nor would any rational tender offeror buy shares lacking voting rights, leaving it unable to protect its investment. To do so would be like buying a house with no roof. By detaching the voting rights from the shares that are to be transferred in interstate tender offers, the Chapter necessarily regulates those tender offers. It chills the myriad of interstate transactions associated with each tender offer. Indeed, that is the Chapter's very purpose.

#### A. The Chapter Has An Unlawful Protectionist Purpose

The Commerce Clause rests on the principle that the "states are not separable economic units." *Philadelphia v. New Jersey*, 437 U.S. 617, 623 (1978), citing *Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 538 (1949). Indiana may not "place itself in a position of economic isolation." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935). As this Court has declared, "[s]hielding in-state industries from out-of-state competition is almost never a legitimate

<sup>11</sup> State restrictions on international commerce are subjected to even more rigorous scrutiny. *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 101 (1984). The markets for corporate control, corporate assets and corporate securities are all international in scope.

local purpose. . . ." *Maine v. Taylor*, 477 U.S. \_\_\_, 106 S. Ct. 2440, 2453 (1986).

Appellants concede that the Chapter is designed to shield Indiana corporations from out-of-state competitors in the interstate market for corporate control. Counsel of record for CTS stated publicly that the Chapter is intended to deter nonresidents from acquiring control of Indiana corporations:

When asked why Indiana had decided to adopt such a virulent statute, James Strain, an Indianapolis corporate lawyer from Barnes & Thornburg says, "We don't like having all our companies taken over by East Coast firms." On further reflection, Strain says Midwestern and West Coast acquirors are no better.

3 *Corporate Control Alert* 1, 10 (March 1986) (DCA App. at 61). Indiana admits that the Chapter is a "regulation of [corporate] takeovers,"<sup>12</sup> (Ind. Br. at 28), which is designed to check the "removal" of Indiana corporations "from the State," (Ind. Br. at 90-91.) (emphasis added).<sup>13</sup> This Court therefore need go no further to find the Chapter *per se* unconstitutional.

#### B. The Chapter Directly Regulates Interstate Commerce

The Chapter is also *per se* violative of the Commerce

<sup>12</sup> Indiana's statement that the Chapter is a "regulation of [corporate] takeovers" squarely contradicts its earlier assertion that the Chapter "does not govern or regulate tender offers . . . ." (Ind. Br. at 10.)

<sup>13</sup> The circumstances of Indiana's adoption of the Chapter further point up its protectionist purpose. The Chapter was passed after nonresidents made bids for two large Indiana corporations. 3 *Corporate Control Alert* 1, 10-11 (March 1986) (DCA App. at 61). It is part of a wave of protectionist anti-takeover legislation designed to avoid

(Footnote continued on the following page)

Clause because, like the anti-takeover act struck down in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), it directly regulates extensive interstate transactions in securities between nonresident shareholders and tender offerors. See also *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. —, 106 S. Ct. 2080 (1986). Direct regulation of nonresidents is inevitable because the Chapter applies even if the tender offeror, 90% of the company's shareholders, the company's management and its principal place of business are located outside Indiana. Indeed, where management owns at least 10% of the corporation's stock, the Chapter applies even if *all* of the non-management shareholders and the tender offeror are from out-of-state.

By arguing that the Chapter is designed to protect

13 (Continued)

this Court's decision in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982). See generally Block, Barton and Roth, *State Takeover Statutes: The Second Generation*, 13 Sec. Reg. L. J. 332 (1986). One of the most common forms of "second generation" anti-takeover legislation has been control share acquisition statutes similar to Indiana's in both operation and effect. Such statutes have been stricken by every court to have considered their constitutionality. See *Gelco Corp. v. Coniston Partners*, Civ. No. 3-86-847 (D. Minn. Nov. 10, 1986) (Minnesota statute); *Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. 742 (S.D. Ohio), *aff'd*, 796 F.2d 135 (6th Cir.), *appeal docketed*, No. 86-344 (U.S. Sept. 2, 1986) (Ohio statute); *Terry v. Yamashita*, 643 F. Supp. 161 (D. Haw. 1986) (Hawaii statute); *APL Ltd. Partnership v. Van Dusen Air, Inc.*, 622 F. Supp. 1216 (D. Minn.), *vacated on other grounds and appeal dismissed*, Nos. 85-5285/5286-MN (8th Cir. Nov. 26, 1985) (Minnesota statute); *Icahn v. Blunt*, 612 F. Supp. 1400 (W.D. Mo. 1985) (Missouri statute). State anti-takeover legislation often is passed in response to a bid for a state's company from an out-of-state bidder. See, e.g., *Icahn v. Blunt*, *supra* (bid for TWA triggered emergency passage of control share acquisition legislation).

"nondominant" shareholders from the effects of a nationwide tender offer (see, e.g., CTS Br. at 34, 36), appellants have implicitly admitted that the Chapter is a direct regulation of interstate commerce. A state statute that "protects" all so-called nondominant shareholders regardless of their state of residence inevitably requires a direct and extraterritorial regulation of interstate commerce.

### C. The Chapter's Effects On Interstate Commerce Are *Per Se* Unconstitutional

Appellants ignore the Chapter's devastating effects on interstate commerce. This Court has emphasized repeatedly that in Commerce Clause cases "[t]he principal focus of inquiry must be the practical operation of the statute, since the validity of state laws must be judged chiefly in terms of their probable effects." See, e.g., *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 37 (1980). Even if the Chapter served legitimate, non-protectionist purposes and did so without directly burdening interstate commerce (which it does not), it would still be *per se* violative of the Commerce Clause because its provisions (1) have a substantial discriminatory effect on nonresident tender offerors in the interstate market for corporate control, thereby (2) inhibiting the interstate transfer of corporate assets (3) requiring business operations to be performed in Indiana which could more efficiently be performed elsewhere and (4) benefitting the management of Indiana corporations at the expense of unrepresented out-of-state parties.

#### 1. The Chapter Has A Discriminatory Effect On Nonresident Tender Offerors In The Interstate Market For Corporate Control

The Chapter's burdens weigh heavily on interstate tender offers, which are a key mechanism in the operation of the interstate market for corporate control. By stripping voting rights from "control shares," the Chapter



removes all value from the tender offer transaction. Unlike other types of stock acquisitions, tender offers often are driven by the desire to purchase the element of potential corporate control that inheres in the voting rights attached to each share of common stock. Tender offerors typically pay a sizeable "control premium" to shareholders as consideration for these voting rights. *See generally* Jensen and Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983). The Chapter falls more harshly upon tender offerors than upon other acquirors by stripping only the voting rights attached to the block of shares that puts a tender offeror over one of the ownership thresholds. Tender offerors purchase shares in large blocks, while other acquirors may cross a threshold through small open market or privately negotiated purchases and the like.<sup>14</sup>

Because it allows incumbent management to opt out of or to opt back into its provisions *after* a tender offer has been made, the Chapter imposes upon even the most intrepid tender offeror an unacceptable investment risk wholly external to the market. The opt-in/opt-out risk destroys the integrity of the securities market. Management alone has possession of material information not available to the market – whether it will in fact opt into the Chapter, opt out of the Chapter, redeem the acquiror's shares or recommend that shareholders reattach some measure of voting rights to the tendered shares. This uncertainty imposes heavy costs on the tender offeror, who must comply with the provisions of the Chapter even before they are applicable or risk finding itself in violation of state law if management opts back into the Chapter. The practi-

<sup>14</sup> Among all the interstate securities transactions to which the Chapter applies, tender offers are especially vulnerable to the opt-in/opt-out provision because they alone must be held open for 20 business days.

cal impact is to deter tender offers for Indiana corporations.

The Chapter's discriminatory effect on tender offers necessarily results in discrimination against nonresidents. Because the securities market is international in scope, most bidders for and shareholders of sizeable, publicly traded Indiana corporations will be nonresidents. Given the Chapter's disparate impact on out-of-state bidders and shareholders, its facial neutrality *vel non* is irrelevant. This case is no different from numerous decisions of this Court striking down facially neutral regulations which disproportionately affect out-of-state parties and impede the flow of interstate commerce. *See, e.g., Southern Pac. Co. v. Arizona*, 325 U.S. 761 (1945).

## 2. The Chapter Impedes The Interstate Transfer Of Corporate Assets

The Chapter also restricts the interstate transfer of corporate assets by disrupting corporate control transactions requisite to those transfers. A tender offeror who later acquires control of a corporation may shift to another state the assets of a newly acquired corporation to take advantage of a business opportunity. *See generally* Ginsburg and Robinson, *The Case Against Federal Intervention in the Market for Corporate Control*, 1986 Winter/Spring BROOKINGS REV. 9. Given its protectionist purpose, it is hardly surprising that the Chapter blocks the flow of corporate assets from Indiana to other states. The Chapter has the same impact as the statute struck down in *Hughes v. Oklahoma*, 441 U.S. 322 (1979). It restricts the out-of-state transfer of a local resource. *See also Philadelphia v. New Jersey*, 437 U.S. 617 (1978).

While the Chapter restricts the flow of corporate assets *from* Indiana to its sister states, it also inevitably curtails the flow of corporate assets *into* Indiana. After acquiring control of an Indiana corporation, some out-of-state tender offerors no doubt will transfer corporate assets into Indiana to take advantage of business oppor-

tunities or to reverse incumbent management's policy of undercapitalization. Unlike the state in *Maine v. Taylor*, 477 U.S. \_\_\_, 106 S. Ct. 2440 (1986), which had compelling health and safety reasons for banning the importation of certain species of fish, Indiana has no compelling justification for restricting the importation of these corporate assets.

### 3. The Chapter Requires Economic Operations To Be Performed In Indiana Which Could More Efficiently Be Performed Elsewhere

The interstate market for corporate control, if unimpeded by protectionist legislation, consists of a continuing series of securities transactions which lead to transfers of control over corporate assets to parties who can make more efficient and profitable use of those assets.<sup>15</sup> Jensen and Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON 5 (1983); see also Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). Where incumbent management resists such corporate control transactions, a tender offer is often the only method of maximizing shareholder wealth. See generally Easterbrook and Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978).<sup>16</sup>

<sup>15</sup> This market is extremely large. In 1985 there were 3,001 corporate control transactions of \$500,000 or more. 3 *Corporate Control Alert* 1, 8 (April 1986) (DCA App. at 62). The total purchase price of these transactions was \$179.6 billion. *Id.*

<sup>16</sup> The other securities transactions that may effect a change in control, such as mergers, exchange of stock and sale of the com-

(Footnote continued on the following page)

The Chapter, by its very design, allows the incumbent management of Indiana corporations to block the interstate transfer of corporate control even if the transfer would result in a more efficient use of corporate assets, increase shareholder wealth and have the support of a majority of *all* shareholders. Indiana shields its corporations from the very bidders who believe they can employ the corporate assets more profitably, thereby interrupting the natural interstate exchange of corporate control and impeding the market process toward greater performance efficiency. See Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 853-854 (1981). Even if Indiana were pursuing a legitimate local interest, the Chapter's effect of forcing business operations to be performed in Indiana which could more efficiently be performed elsewhere is *per se* unconstitutional. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970); *Toomer v. Witsell*, 334 U.S. 385, 403-406 (1948).

### 4. The Chapter Benefits The Management Of Indiana Corporations At The Expense Of Unrepresented Nonresident Parties

The Chapter impermissibly furthers "[e]conomic protectionism" by giving Indiana corporations "an advantage over consumers" of corporate control in other

---

16 (Continued)

pany, are largely governed by incumbent management. Only proxy challenges are initiated by shareholders and their ineffectiveness prompted the rise of tender offers. Gilson, *A Structural Approach To Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 843 (1981). Tender offers are extended directly to the shareholders, who, protected by the Williams Act, may choose to tender their shares for sale to the tender offeror based upon their own investment criteria and without undue pressure from management or the tender offeror.



states. *Brown-Forman Distillers Corp.*, 106 S. Ct. at 2088. Indiana deputizes the management of its corporations to deprive potential nonresident acquirors of the competitive advantages they may have earned for themselves in the interstate market for corporate control through their greater efficiency, management skills and business acumen. See *Hunt v. Washington Apple Advertising Comm'n.*, 432 U.S. 333, 351 (1977). The Chapter gives to the management of Indiana corporations competitive advantages which they have failed to earn. It does so by disadvantaging nonresidents.

The Chapter's burdens fall most heavily on out-of-state parties who were not represented in the Indiana legislature. See *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 92 (1984); Romano, *The Political Economy of Takeover Statutes*, 41 Va. L. REV. \_\_\_\_ (1987) (forthcoming in February, 1987). It leaves Indiana corporations free to acquire corporations in other states and to shift newly acquired corporate assets to Indiana.<sup>17</sup> It places no limits on the transfer out of state of Indiana corporate assets by the management of Indiana corporations, but prevents out-of-state acquirors from doing the same. Those out-of-state acquirors had no say in the Indiana legislature, even though the Chapter is a major obstacle to their obtaining control over Indiana corporations. Nor were out-of-state shareholders of Indiana corporations represented, even though the Chapter will deprive them of the premiums and the profits from efficiency gains that result from tender offers.

The primary recourse for these unrepresented parties

---

<sup>17</sup> Indeed, in 1982 CTS availed itself of the interstate market for corporate control by using a tender offer to help effect a merger between one of its subsidiaries and a Minnesota corporation. See *CTS Reports on Tender* (NEXIS, PR Newswire, Feb. 26, 1982); *CTS Corp. Acquisition* (NEXIS, PR Newswire, Jan. 11, 1982).

is to persuade their own state legislatures to pass protectionist legislation that will reverse the Chapter's effects. The Chapter thus portends a wave of retaliatory legislation. If appellants' position were law, each state would be free to "experiment," not with creative economic development programs, but with various ways to prevent nonresident tender offerors from obtaining control of resident corporations, while giving resident corporations free rein to obtain control of out-of-state corporate assets and to shift those assets to the "experimenting" state. See *Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 538-39 (1949).<sup>18</sup>

Appellants seek to excuse these systemic biases by claiming that potential in-state bidders for Indiana corporations "virtually" represented the interests of nonresident bidders in the Indiana legislature. (CTS Br. at 34; Ind. Br. at 85.) The number of Indiana bidders who might be burdened by the Chapter, however, is disproportionately low compared to the number of burdened out-of-state bidders. Moreover, their political influence in the Indiana legislature is weaker than that of the Indiana business interests protected by the Chapter. Indiana corporate bidders also receive a benefit from the Chapter not available to out-of-state bidders — they are shielded from bids from acquirors located in Indiana's 49 sister states. Even the resident shareholders of Indiana corporations are not likely to be as organized or as potent a force in the Indiana legislature as are the local business interests who saw the Chapter as a means of insulating Indiana corporations from the market for corporate control and keeping in Indiana corporate assets that might be utilized more efficiently elsewhere. State anti-takeover statutes are typi-

---

<sup>18</sup> CTS anticipates this argument by claiming that the state of Indiana is free to be wrong. (CTS Br. at 47.) But Indiana is not even free to be right in its experiment where, as here, it discriminates against interstate commerce.

cally the product of the local business community. See *Romano, supra*. The Chapter is no exception, 3 *Corporate Control Alert* 1, 10-11 (March, 1986).

**D. The Chapter's Unnecessary Burdens On Interstate Commerce Far Outweigh Any Local Benefits**

The Chapter's *per se* invalidity obviates the need for this Court to engage in any balancing of local and national interests. But even if the Chapter were not unlawful *per se*, its unnecessary burdens on interstate commerce impermissibly exceed its putative local benefits. See *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

**1. The Burdens On Interstate Commerce Are Great**

Indiana has used the Chapter to "slow or freeze the flow of commerce for protectionist reasons... by erecting a barrier against the movement of interstate trade." *Philadelphia v. New Jersey*, 437 U.S. 617, 628 (1978); see also *Dean Milk Co. v. Madison*, 340 U.S. 349, 354 (1951). The Chapter burdens three large and vigorous interstate markets. It chills the market for corporate control by hindering the operation of a key component of that market — the tender offer mechanism. The Chapter inhibits the operation of the market for corporate assets, whose liquidity depends on transfers in corporate control. See Bradley, Desai and Kim, *The Rationale Behind Interfirm Tender Offers*, 11 J. FIN. ECON. 183, 183-84 (1983). The Chapter also disrupts the interstate market in securities by forcing shareholders who want to sell their shares to tender offerors to obtain the approval of at least two groups of shareholders.

This Court has recognized the harm to the national economy and shareholders nationwide when a state blocks a tender offer that complies with the Williams Act:

Shareholders are deprived of the opportunity to

sell their shares at a premium. The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.

*MITE*, 457 U.S. at 643.

**2. The Chapter's Benefits Are Negligible**

Indiana and CTS have settled on two *post hoc* rationalizations for the Chapter: (1) protection of "nondominant" shareholders, and (2) protection of local economic interests. Neither of these purported benefits would outweigh the Chapter's many burdens on interstate commerce even if they were real. But they are not.

**a. The Rationale of Protecting Nondominant Shareholders Is A Pretext**

This Court has already decided that a state has "no legitimate interest in protecting the nonresident shareholders." See *MITE*, 457 U.S. at 644. By claiming that its statute is designed to protect so-called nondominant shareholders *nationwide*, Indiana gives this Court little to weigh in the balance against the Chapter's burden on interstate commerce. This is particularly true because management's opt-in/opt-out exemption power is inconsistent with shareholder protection, the Chapter is not rationally related to its purported shareholder protection goal, and the Chapter is based on irrational premises.

**i. Management's Exemption Power Is Inconsistent With Shareholder Protection**

Like the statute in *MITE*, the Chapter allows management to invoke the Chapter to defeat a "hostile" tender



offer.<sup>20</sup> The Chapter will protect tendering shareholders from no one but themselves by subjecting their voluntary sale of securities to the approval of at least two shareholder groups: all shareholders and "disinterested" shareholders. Having used the Chapter to defeat a tender offer, management can exempt itself from the Chapter in order to conduct a defensive self-tender or to promote a "friendly" tender offer. In such a case, the so-called non-dominant shareholders are left with what appellants would have this Court believe are the inadequate investor protections of the Williams Act. This sharp incongruity between the *post hoc* rationalization for a statute and its practical effects "tend[s] to undermine appellant's justification for the burdens the statute imposes on interstate commerce." *MITE*, 457 U.S. at 644. See also *Raymond Motor Trans., Inc. v. Rice*, 434 U.S. 429, 446-47 (1978).

ii. **The Chapter Is Not Rationally Related To Its Purported Purpose**

Even if the purpose of the Chapter were the protection of nondominant shareholders, the Chapter is intolerably overbroad and underinclusive. The Chapter is overbroad because it is not limited to "coercive" partial tender offers or even to all partial tender offers. It comes into play indiscriminately and applies to "any and all" tender offers, open market purchases, privately negotiated stock purchases and the full range of other share acquisitions regardless of the effect of these acquisitions on shareholders. It applies regardless of whether the share acquisition is intended to or even can lead to actual control over the operation of the corporation. Yet, it is also capriciously underinclusive be-

<sup>20</sup> Management and shareholders have divergent interests when corporate control is at stake. See, e.g., *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985) (noting the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders" when responding to a tender offer).

cause it establishes procedures by which management may exempt certain self-serving control share transactions by opting out of the Chapter.

The poor fit between the Chapter and its purported purpose is even more intolerable because the Chapter is unnecessary. Other Indiana laws are tailored to prevent oppressive conduct by a large shareholder, are not triggered at the whim of management and are far less restrictive of interstate commerce. Indiana, for example, requires shareholder approval of mergers, IND. CODE § 23-1-40-3, the sale of corporate assets, IND. CODE § 23-1-41-2, and the dissolution of the corporation, IND. CODE § 23-1-45-2(b)(2). Indiana vests its shareholders with dissenter's rights. IND. CODE § 23-1-44-1 *et seq.* Indiana allows its corporations to protect their shareholders against financially inadequate second stage transactions by adding, with shareholder approval, a fair price amendment to the corporate charter. See *Dynamics Corp. of America v. CTS Corp.*, 805 F.2d 705, — (7th Cir. 1986) (slip op. at 13). See also IND. CODE § 23-1-43-1 *et seq.* (statutory fair price amendment). "Dominant" shareholders are also restrained by the fiduciary obligations they owe to other shareholders under Indiana law.<sup>21</sup>

Finally, the Chapter disserves a shareholder protection purpose. It distorts shareholder choice. The Chapter gives management — which otherwise would have no direct role in the tender offer except for opining on its merits to the shareholders — the opportunity to preempt shareholder choice by wielding a formidable array of pro-management provisions against tender offers. Indeed, the Chapter permits a minority of so-called disinterested shareholders to

<sup>21</sup> The Williams Act as well ensures that the shareholders will know the second stage plans of the partial tender offeror by requiring the offeror to state what major changes it plans to make in the structure or operation of the corporation. 15 U.S.C. § 78m(d)(1)(C).

block a majority of shareholders from selling their shares to the tender offeror.

### iii. The Chapter Is Based Upon Irrational Premises

The very notion that interstate tender offers must be heavily burdened in order to protect some shareholders against other "dominant" shareholders rests upon at least three premises so irrational that they belie the Chapter's purported purposes. The first premise is that partial tender offers are bad because they (a) sometimes result in the purchase of shares by a party who may (b) sometimes become a "dominant" shareholder and who may (c) sometimes arrange a second step transaction that may (d) sometimes yield shareholders a lower premium than they received initially. This, of course, also assumes that no statutory fair price amendment exists (as it does in Indiana, IND. CODE § 23-1-43-1 *et seq.*) or that the corporation has not adopted its own fair price amendment. Indiana's premise is not only attenuated, it is erroneous. No necessary connection exists between partial tender offers and "coercive" second-step transactions. Many partial tender offers are not followed by second-step transactions. Securities and Exchange Commission's Advisory Committee on Tender Offers, *The Economics of Partial and Two-Tier Tender Offers*, 49 FED. REG. 26755 (1984). Moreover, the empirical data show that the premiums offered shareholders in any and all tender offers exceed the sum of the premiums offered shareholders in two-step transactions by only a small margin. *Id.* at 26759.

The second erroneous premise is that stock ownership as low as 20% gives the acquiring person actual control over the corporation. Suppose, for example, four factious individuals each purchased 20% of the stock of an Indiana corporation. The Chapter would regulate each shareholder as an "acquiring person." Yet, can appellants contend with a straight face that any of these shareholders have

"control" over the corporation? And can they honestly suggest that by crossing the Chapter's 20% threshold, DCA somehow obtained "control" over CTS? The fact is that after acquiring a 27.5% ownership position in CTS through its tender offer, DCA lost its bid to seat its slate of directors on the CTS Board. By no stretch of the imagination is DCA in "control" of CTS. DCA cannot compel or block the sale or merger of CTS or force any other fundamental change in the corporation.

Finally, the Chapter irrationally assumes that "acquiring persons" pose a threat to "nondominant" shareholders. Not only is there no logical link between tender offers by an "acquiring person" and the exploitation of minority shareholders, but small shareholders typically benefit from the presence of a large shareholder. Schleifer and Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461 (1986). Large shareholders have both the incentive to monitor aggressively management's performance and the financial resources to do so. The benefits that result from such monitoring inure to all shareholders. The presence of a large shareholder also facilitates corporate control transactions that provide shareholders with opportunities for both control premiums and increased profits from the more efficient use of corporate assets. See generally Holderness and Sheehan, *Raiders or Saviors? The Evidence on Six Controversial Investors*, 14 J. FIN. ECON. 555 (1985). The data show that the presence of a large shareholder typically causes an increase in the value of the company's stock. Mikkelsen and Ruback, *An Empirical Analysis of the Interfirm Equity Investment Process*, 14 J. FIN. ECON. 523 (1985).



**b. The Chapter Provides No Legitimate Benefit To Other Local Interests**

Indiana concedes that the Chapter was motivated by its desire to protect local economic interests from the effect of interstate tender offers. (Ind. Br. at 90-91.) But, as this Court observed in *Lewis v. BT Inv. Managers, Inc.*:

In almost any Commerce Clause case it would be possible for a State to argue that it has an interest in bolstering local ownership, or wealth, or control of business enterprise. Yet these arguments are at odds with the general principle that the Commerce Clause prohibits a State from using its regulatory power to protect its own citizens from outside competition.

447 U.S. at 43-44. If, as Indiana admits, the Chapter attempts to shield Indiana economic interests from outside competition in the market for corporate control, it is *per se* unlawful. Even if the Chapter is not *per se* unconstitutional, Indiana's interest in protecting local business does not shield the Chapter from Commerce Clause scrutiny. Indiana would have this Court weigh in its favor the economic welfare of employees, shareholders and other nonmanagement parties. The Chapter, however, does not protect these interests. It delegates to incumbent management enforcement powers and lacks regulatory standards designed to protect nonmanagement interests.<sup>22</sup>

**3. Appellants' "Internal Corporate Affairs" Argument Is Without Merit**

Appellants argue that the Chapter is an innocuous regulation of the internal affairs of Indiana corporations

<sup>22</sup> The Chapter therefore is not analogous to the Maryland statute prohibiting vertically integrated petroleum producers and refiners from operating local retail outlets upheld in *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 124-25 (1978). The Maryland statute was passed not for protectionist purposes,

(Footnote continued on the following page)

that gives shareholders the right to ratify a fundamental change in the structure of the corporation by approving or disapproving a tender offer. They analogize the Chapter to provisions requiring shareholder approval of mergers and other changes in the structure of the corporation.

Appellants' analogy, however, is wrong. In rejecting this overworked analogy in *MITE*, this Court recognized that tender offers do not implicate the internal affairs of the corporation. *MITE*, 457 U.S. at 645-46.<sup>23</sup> Tender offers are transactions in interstate commerce between the tender offeror and shareholders through which the tender offeror assembles a block of shares. Tender offers themselves do not change the fundamental structure of the corporation. Nor do they define "relationships among or between the corporation and its current officers, directors,

<sup>22</sup> (Continued)

but in response to market data which revealed the inequitable distribution of gasoline among retailers during a period of short supply. Maryland reduced that inequity *not* by deterring all out-of-state retail competitors, but by measures precisely tailored to eliminate the inequities. The Maryland law thus permitted many interstate competitors to enter local markets.

The Chapter, in contrast, blocks all nonresident competitors in the interstate markets for corporate control and assets. Indiana admittedly protects local corporations by stopping the flow of *all* control share transactions, leaving no interstate competition. See *Lewis v. BT Inv. Managers, Inc.* 447 U.S. 27, 42 (1980). Because the Maryland statute upheld in *Exxon* left out-of-state petroleum retailers on an equal competitive footing with existing in-state retailers, that statute did not significantly affect the overall level of local competition in the industry. The Chapter, however, will depress competition between incumbent management and out-of-state acquirors for control of Indiana corporations.

<sup>23</sup> This Court also observed that the "internal affairs doctrine" is not a product of corporation law at all, but a "conflict of laws principle." *MITE*, 457 U.S. at 645.



and shareholders." See *MITE*, 457 U.S. at 645.

A tender offer alone does not give the tender offeror control over a corporation, but only a block of shares. Mikkelsen and Ruback, *An Empirical Analysis of the Interfirm Equity Investment Process*, 14 J. FIN. ECON. 523, 550 (1985). To effect any change in the structure or control of the corporation, the offeror must exercise the voting power attached to the purchased shares. All attempts by successful tender offerors to parlay their share ownership position into control over the corporation, and especially any attempt on their part to effect a change in the corporate form, are subject to a vast range of regulations under state law. Indiana law, for example, guarantees shareholders an opportunity to elect the corporation's board of directors and to approve a merger, sale of corporate assets, dissolution of the corporation and other initiatives that directly affect the structure of the corporation.<sup>24</sup>

Notwithstanding appellants' dire warnings, this Court's decision affirming the Seventh Circuit would not federalize state corporate law. To the contrary, it is the Indiana legislature that has attempted to federalize its own corporate law. Even if the Chapter were construed as a regulation of the "internal affairs" of Indiana corporations, its burden on interstate commerce far outweighs the local benefits. The Chapter must fall because its method of regulating control interferes directly with the operation of the tender offer mechanism, thus discriminating against interstate commerce. The Seventh Circuit properly

<sup>24</sup> Shareholder approval of changes in the control over or structure of the corporation provides a critical check on the controlling party's actions in arranging transactions which implicate the corporate form. In telling contrast, Indiana law does not require shareholder approval of tender offers and other "control share" acquisitions, but leaves to management substantial discretion in applying the Chapter.

focused on the real world impact of the Chapter on interstate commerce and its decision stands for the unremarkable proposition that a state law that has a "direct, substantial and intentional" effect upon interstate commerce by interfering with the tender offer mechanism is unconstitutional. See *Dynamics*, 794 F.2d at 264.

#### 4. Congress Has Not Delegated This Regulatory Authority To The States

Appellants' effort to derive congressional approval for the Chapter from Section 28(a) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78bb(a) (1982) must fail. That section was designed to preserve blue sky laws, which long preceded the Exchange Act and the protections of which apply only to resident investors. See 1 L. Loss, *Securities Regulation* 30-31 (2d. ed. 1961). As appellants well know, congressional authorization of state legislation which interferes with interstate commerce "must be unmistakably clear." *Maine v. Taylor*, 477 U.S. \_\_\_, 106 S. Ct. 2440, 2448 (1986). Section 28(a), 15 U.S.C. § 78bb(a), is not an "unmistakably clear" delegation to the states of the power to interfere with the interstate markets in corporate control, assets and securities.<sup>25</sup> Not only has Congress failed to authorize the Chapter, but it has preempted it.

## II. THE CHAPTER IS PREEMPTED BY THE WILLIAMS ACT

The Chapter is preempted because it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" in enacting

<sup>25</sup> Section 28(a) states in relevant part: "Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any state over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder."

the Williams Act. *Hines v. Davidowitz*, 312 U.S. 52, 67-68 (1941). The Indiana legislature has established a regulatory scheme that conflicts with the execution and accomplishment of Congress' investor protection objectives.

#### A. The Chapter Conflicts With The Williams Act's Market Method Of Investor Protection

Even if the Chapter were designed to protect investors,<sup>26</sup> it conflicts with the method of investor protection selected by Congress. Congress selected a "market" method of tender offer regulation which is based upon disclosure and designed to promote investor free choice. See generally *Great W. United Corp. v. Kidwell*, 577 F.2d 1256, 1276 (5th Cir. 1978), *rev'd on venue grounds sub nom., Leroy v. Great W. United Corp.*, 443 U.S. 173 (1979). Indiana has established a paternalistic regulatory scheme that usurps investor free choice.

The Williams Act amendments to the Exchange Act were passed in 1968 to extend the federal securities laws' disclosure provisions into the largely unregulated field of tender offers.<sup>27</sup> In constructing legislation to accomplish its investor protection goal, Congress chose between two different methods, one based upon disclosure and the other upon externally imposed principles of "fairness" or "artificiality." *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 8 n.8 (1985). See also *Kidwell*,

<sup>26</sup> As demonstrated at pages 21-25, *supra*, appellants' investor protection rationale is a pretext at best. In offering that rationale, appellants acknowledge the Chapter's repudiation of Congress' evenhanded market approach. Thus, the Chapter is defended as a means of avoiding the "unfair treatment" of shareholders. See, e.g., CTS Br. at 25.

<sup>27</sup> Prior to the mid-1960's, corporate takeover attempts had typically involved either proxy solicitations, regulated under Section 14 of the Securities Exchange Act of 1934, 15

(Footnote continued on the following page)

*supra*. at 1279. Congress rejected the latter approach. *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Committee on Banking and Currency*, 90th Cong., 1st Sess. 1, 198 (1967) [hereinafter Full Disclosure Hearing] (Second Statement of Manuel F. Cohen, Chairman Securities and Exchange Commission) (... this bill does not contemplate nor does it provide for substantive regulation of tender offers ...)

As with its other legislation in the federal securities field, Congress concluded that the only way to protect investors without also chilling legitimate transactions (in this case, tender offers) in the underlying market was through a "calculated reliance on disclosure." See *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 8 n.8 (1985). The *MITE* plurality outlined the method of tender offer regulation adopted by Congress:

... Congress intended to strike a balance between the investor, management, and the takeover bidder. The bidder was to furnish the investor and the target company with adequate information ...

*MITE*, 457 U.S. at 634. The plurality also cautioned that Congress had rejected any regulatory approach that supplanted investor free choice:

<sup>27</sup> (Continued)

U.S.C. § 78n (1964), or exchange offers of securities, subject to the registration requirements of the Securities Act of 1933, 15 U.S.C. § 77e (1964). H.R. Rep. No. 1711, 90th Cong., 2d Sess., reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811. When Congress passed the Williams Act, only Virginia had a statute regulating tender offers. Take-Over-Bid Disclosure Act, VA. CODE ANN. § 13.1-528 (1985 Replacement Volume). There is no indication that Congress was aware of the Virginia statute, which was passed only four months before the Williams Act. Nor is there any evidence in either the text of the Williams Act or its legislative history that Congress ever intended or expected states to play an active role in tender offer regulation.



... but there was no "inten[tion] to do... more than give incumbent management an opportunity to express and explain its position." [citation omitted] Once that opportunity was extended, Congress anticipated that the investor, if he so chose, and the takeover bidder should be free to move forward within the time frame provided by Congress.

*Id.* at 634. See also *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975).

The Williams Act, therefore, is finely tuned to facilitate informed shareholder choice based on the investment criteria of each shareholder and the disclosures of the tender offeror and management. H.R. Rep. No. 1711, 90th Cong., 2d Sess., reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811; see also, S. Rep. No. 550, 90th Cong., 1st Sess. (1967). The Williams Act requires both the tender offeror and management to disclose information to the shareholder erelevant to the tender offer decision. 15 U.S.C. § 78m(d). In addition, it insulates the shareholder from any external pressures affecting his or her decision whether to tender shares for sale to the tender offeror. See 15 U.S.C. § 78m(d)(1).<sup>28</sup>

The Chapter deprives individual shareholders of the free choice guaranteed to them by this federal regulatory scheme. It anoints three overlapping factions of guardians: management and at least two groups of shareholders. Each shareholder group has independent veto power over the individual shareholder's decision to sell shares to the tender offeror. The Chapter does not provide these guar-

<sup>28</sup> Thus, tender offerors must hold open their tender offers for 20 business days, 17 C.F.R. § 240.14e-(1a) (1986), shareholders can withdraw their tendered shares during specifically established periods, 15 U.S.C. § 78n(d)(5), tender offerors must accept shares on a pro rata basis, 15 U.S.C. § 78n(d)(6), and tender offerors must pay the same consideration to all tendering shareholders. 15 U.S.C. § 78n(d)(7).

dians with additional tools to "protect" shareholders from the very tender offeror to whom they may have already tendered their shares. Neither the tender offeror nor incumbent management is required to make any additional disclosures that might assist shareholder guardians in making the voting rights decision. Yet, that decision will determine the tender offeror's fate.<sup>29</sup> If even one group of shareholder guardians rejects the tender offer, the Chapter will have undone the myriad of investment decisions of the individual shareholders.

The Chapter imposes the sort of external restrictions on shareholder free choice that were rejected by Congress. It also confounds the Williams Act's market approach to tender offer regulation by forcing shareholders to make the voting rights decision with no guarantee of adequate information. If Indiana believes that the Williams Act provides the shareholder guardians with the information necessary to make an informed decision on the voting rights issue, then the Chapter's expensive and time-consuming procedures are superfluous, albeit highly obstructive of tender offers and inconsistent with the Williams Act's approach. If Indiana believes that the voting rights decision upon which the success of every tender offer depends is an important component of the tender offer process, then the Chapter's pro-management bias and lack of disclosure requirements ill-equip it to promote informed shareholder decisionmaking and likewise conflict with Congress' market approach.

<sup>29</sup> Moreover, once a tender offeror has purchased shares, the other shareholder guardians have no incentive to vest the tender offeror's shares with voting rights because this would only dilute the voting power of their shares.



**B. The Chapter Frustrates The Williams Act's Investor Protection Purpose By Conflicting With Its Policy Of Neutrality**

The Williams Act's investor protections rest upon a careful balance struck by Congress between incumbent management and tender offerors. S. Rep. No. 550, 90th Cong., 1st Sess. 1, 3 (1967); *see also* H.R. Rep. No. 1711, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. CODE CONG. & ADMIN. NEWS 2811. Congress established a policy of neutrality between management and the tender offeror as "a major aspect of the effort to protect the investor." *MITE*, 457 U.S. at 633 (plurality opinion). *See also* *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 29-30 (1977).

Congress adopted this policy of neutrality after painstaking deliberation. Initially, the drafters of the Williams Act considered regulating tender offers by strengthening the position of both management and shareholders vis-à-vis tender offerors. Senator Williams introduced a precursor bill to the Williams Act with a message entitled "Protection Against Corporate Raiders," that decried "proud old companies [being] reduced to corporate shells after white collar pirates have seized control." S. 2731, 89th Cong., 1st Sess. 111 CONG. REC. 28257 (1965). The most potent pro-management feature of this precursor bill was a provision requiring tender offerors to disclose to management their intent to make a tender offer 20 days before commencing the offer. When coupled with a 20 business day waiting period, this provision would have given management approximately 50 days to take defensive measures against a tender offer.

But after hearing extensive testimony on the benefits of tender offers to shareholders and the success of management in defeating tender offers, *see, e.g.*, Full Disclosure Hearing, *supra*, Congress acknowledged that investors benefit from the continued operation of the tender offer mechanism. H.R. Rep. No. 1711, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. CODE CONG. & ADMIN. NEWS

2811. Senator Williams disclaimed any Congressional intent to impair the operation of the tender offer mechanism by favoring incumbent management. *See, e.g.*, 113 CONG. REC. 5854 (1967) ("Every effort has been made to avoid tipping the balance of the regulatory burden in favor of management or in favor of the offeror."). Consequently, Congress removed all precommencement notification requirements from the Williams Act. Instead, Congress protected the investor "by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice." *MITE*, 457 U.S. at 634.<sup>30</sup>

The Chapter returns to management the "undue advantage" withheld by Congress. Indiana severely handicaps tender offerors by giving management its most potent defensive weapon: delay.<sup>31</sup> *See MITE*, 457 U.S. at 637-638. It resurrects the very 50 day window for defensive tactics that Congress expressly rejected when it deleted from the

<sup>30</sup> CTS cites this very language, but then makes the inconsistent claim that the Chapter, by regulating only "post-acquisition voting rights," addresses concerns "entirely different" from ensuring that "the investor makes an 'informed choice' whether to tender his shares." (CTS Br. at 24-25.) In attempting to find some rationale for the Chapter, of course, CTS tries to convince this Court of the opposite proposition, that the Chapter has everything to do with ensuring that the investor makes an informed choice. *See, e.g.*, CTS Br. at 25, 26, 37-40.

<sup>31</sup> Congress recognized the harmful consequences of delay in the tender offer process when it enacted the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 1311 *et seq.* (1982) ("Hart-Scott-Rodino Act"):

[I]t is clear that this short waiting period [the 10-day period for proration provided by § 14(d)(6) of the Securities Exchange Act, which applies only after a tender offer is commenced] was founded on congressional concern that a longer delay might

(Footnote continued on the following page)

Williams Act the 20-day precommencement notification requirement.<sup>32</sup> The Chapter's procedure for holding a spe-

<sup>31</sup> (Continued)

unduly favor the target firm's incumbent management, and permit them to frustrate many pro-competitive cash tenders. This ten day waiting period thus underscores the basic purpose of the Williams Act—to maintain a neutral policy towards cash tender offers, by avoiding lengthy delays that might discourage their chances for success.

H.R. Rep. No. 1373, 94th Cong., 2d Sess. 12, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 2572, 2644; see also, 122 CONG. REC. 30877 (1976) (Statement by Representative Rodino). Incredibly, Indiana analogizes the Chapter to the Hart-Scott-Rodino Act in support of its claim that the Chapter will not interfere with tender offers. (Ind. Br. at 68-69.) Indiana ignores the fact that the Hart-Scott-Rodino Act accelerates the regulatory review process in the case of cash tender offers so that review can be completed within the 20 business day Williams Act waiting period. See 16 C.F.R. § 803.10(b) (1986).

<sup>32</sup> Congress repeatedly has rejected precommencement notification provisions that would have extended tender offers beyond 20 business days. In 1965, Congress rejected a proposed 20 day prenotification requirement. See S. 2731, 89th Cong., 1st Sess., 111 CONG. REC. 28257, 28259 (1965). In 1967, Congress rejected a five-day prenotification requirement. S. Rep. No. 550, 90th Cong., 1st Sess. 1, 4 (1967); *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 72-75, 87-89, 98, 105, 139-40, 151, 163, 245 (1967); *Takeover Bids: Hearings on H.R. 14475 and S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. 1, 44-46, 50-54 (1968). In 1970, Congress rejected 30-day prenotification proposal. See *Investor Protection in Corporate Takeovers: Hearings on H.R. 4285, S. 3431 and S. 336 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 2d Sess. 1, 6-7 (1970). In 1975 Congress rejected two bills which would have required a 60-day precommencement filing. S. 2522, 94th Cong., 1st Sess., 121 CONG. REC. 32839, 32840 (1975); H.R. 10650, 94th Cong., 1st Sess., 121 CONG. REC. 35640 (1975).

cial shareholders meeting guarantees management over three additional weeks to implement a variety of defensive measures designed to thwart the tender offer. Tender offerors cannot purchase tendered shares after the expiration of the Williams Act's 20 business day waiting period. They must wait at least 50 days to buy what the shareholders tendered: an equity security with full voting rights.

The Chapter not only arms management with delay, it also:

- (1) Vests management with discretion to invoke the Chapter;
- (2) Increases the amount and scope of proxy materials;
- (3) Subjects the shareholder's decision to sell securities to an effective veto by management and at least two groups of shareholder guardians;
- (4) Permits management to redeem tendered shares pursuant to its own procedures;
- (5) Raises transaction costs of making a tender offer; and
- (6) Gives management complete control over the Chapter's enforcement mechanism.

Indiana argues that the Chapter is not preempted by the Williams Act because tender offerors may condition their tender offers on the eventual approval of a voting rights resolution by the shareholder guardians. (Ind. Br. at 65.) This argument ignores the fact that before the voting rights issue is resolved, management has free rein to take other defensive steps that will diminish the value of tendered shares. The same argument can be made to excuse any pro-management restriction on the tender offer process, no matter how burdensome. A tender offeror could just as easily condition its tender offer if the Chapter imposed a delay of 50 weeks rather than 50



days. But Congress did not empower the states to burden the tender offer process with delay, uncertainty and additional costs under the banner of "investor protection." Indiana's compliance manual only illustrates how tender offerors must modify substantially their tender offers from the Williams Act norm to comply with the Chapter.

CTS concedes that "Congress *itself* did not wish to 'tip the balance' " between tender offerors and management, but argues that the congressional policy of neutrality places no limits on the power of a state to impair the operation of the tender offer mechanism in order to protect the management of its corporations. (CTS Br. at 21, 22.) Appellants' Supremacy Clause argument is nothing less than the blanket assertion that Indiana has unbridled discretion to impose on the tender offer process burdens of any magnitude. Whatever role is left to the states in the field of securities regulation after over 50 years of extensive federal involvement, it certainly does not include enacting legislation which admittedly is in conflict with the Williams Act. Appellants' inverted view of federalism was repudiated by *MITE* and fails to acknowledge that Congress believed that tender offer regulation tipped in management's favor would be inconsistent with the Williams Act.

### CONCLUSION

For the foregoing reasons, the decision of the Seventh Circuit Court of Appeals should be affirmed.

Dated: January 20, 1987

Respectfully submitted,

LOWELL E. SACHNOFF

*Counsel of Record for Appellee*

WILLIAM N. WEAVER, JR.

DEAN A. DICKIE

SARAH R. WOLFF

MICHAEL J. KAUFMAN

THOMAS J. BAMONTE

OF SACHNOFF WEAVER & RUBENSTEIN, LTD.

30 S. Wacker Drive

Suite 2900

Chicago, Illinois 60606

(312) 207-1000